Joint Committee on Taxation
July 27, 1983
JCX-21-83

SUMMARY OF GAO REPORT TO THE JOINT COMMITTEE ON TAXATION ON LEGISLATIVE CHANGE NEEDED TO ENABLE THE IRS TO ASSESS TAXES VOLUNTARILY REPORTED BY TAXPAYERS IN BANKRUPTCY

The United States General Accounting Office (GAO) recently issued a report to the Joint Committee on Taxation examining the effect of bankruptcy laws on Federal tax administration ("Legislative Change Needed to Enable IRS to Assess Taxes Voluntarily Reported by Taxpayers in Bankruptcy," GAO Report No. GGD-83-47, June 20, 1983). Specifically, the report examines the impact on the Internal Revenue Service (IRS) and bankrupt taxpayers of the 1978 bankruptcy reform act's restrictions on tax assessments.

The following is a brief summary of GAO's findings and recommendations.

GAO Findings

The Tax Assessment Process

Tax assessments are bookkeeping entries required by the Internal Revenue Code to record tax liabilities in IRS records. Taxes are assessed when the IRS processes returns as filed by taxpayers. Additional taxes may be determined to be due as a result of subsequent examinations of tax returns. These "examination-determined" taxes are not assessed until the taxpayer either agrees to the IRS findings or exhausts administrative and judicial appeal rights.

Before enactment of the 1978 bankruptcy act, the Internal Revenue Code permitted the IRS, in the case of a taxpayer in a bankruptcy proceeding, to assess examination-determined taxes before the taxpayer had the opportunity to appeal the IRS determination. The 1978 Act restricts the IRS from "any act to collect, assess, or recover a claim against a debtor." This restriction has the effect, among others, of preventing the IRS from assessing taxes (i.e., making bookkeeping entries) in the case of a taxpayer in bankruptcy unless a bankruptcy court lifts the restriction. This restriction applies whether the taxes are voluntarily reported by the taxpayer as due or are determined by the IRS following examination of the taxpayer's return.

The Collection Process

Following assessment of taxes, IRS computerized collection procedures generally result in a series of four notices demanding payment being sent to a taxpayer who has not paid the tax liability. If taxes are not paid pursuant to these notices, or if collection is determined to be in jeopardy, the IRS can levy on the taxpayer's property to

secure payment. However, the restriction in the 1978 bankruptcy statute on IRS actions to collect taxes of taxpayers in bankruptcy (quoted above) precludes collection actions against these taxpayers.

Impact on IRS

Prohibiting the assessment of taxes which taxpayers in bankruptcy cases have voluntarily reported as due on their returns requires the IRS to identify returns of such taxpayers and to process these returns outside of the agency's regular automated processing procedures. The cost of this special processing was estimated to be approximately $270,000 in 1981 and $514,000 in 1982.

Similarly, prohibiting collection of taxes owed by taxpayers in bankruptcy cases requires the IRS to identify returns of these taxpayers and remove them from the automated collection process. At the present time, the IRS has no procedure for stopping the automated collection process with respect to bankrupt taxpayers. GAO estimates that establishing such a procedure would entail a one-time cost of approximately $65,000.

GAO Recommendations

GAO recommended that Congress amend the 1978 bankruptcy statute to eliminate the present prohibition on assessing taxes voluntarily reported on returns by taxpayers. GAO concluded that such an amendment would eliminate unnecessary administrative expenses of handling tax returns of such taxpayers, without adversely affecting the administration of the bankruptcy laws or the rights of the taxpayers to contest disputed tax determinations.

GAO further recommended that the IRS modify its automatic collection procedures to prevent issuance of collection notices to taxpayers in bankruptcy cases.

IRS Comments

The IRS concurred with the recommendations in the GAO report.

Availability of GAO Report

Copies of the GAO report are available from the U.S. General Accounting Office, Document Handling and Information Services Facility, Post Office Box 6015, Gaithersburg, Maryland 20760; (202) 275-6241.